

NATIONAL FOREIGN TRADE COUNCIL, INC.

1625 K STREET, NW, WASHINGTON, DC 20006-1604

TEL: (202) 887-0278



FAX: (202) 452-8160

Comments to the International Tax Working Group

Mr. Chairman, Ranking Member Levin, and Reps. Nunes and Blumenauer

The NFTC appreciates the commitment of Chairman Camp and the Ways and Means Committee and the working groups to comprehensive tax reform. We commend the Committee for engaging stakeholders and for conducting an open and transparent process.

The NFTC, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which worldwide American companies can be dynamic and effective competitors in the international business arena.

The NFTC comments provide some background on comprehensive tax reform, a discussion of the current U.S. tax structure, and recommendations to enhance the ability of worldwide American companies to compete in the global market as well as their ability to invest and create jobs in the United States.

Comprehensive Tax Reform

As discussed in more detail below, comprehensive tax reform is necessary to address the changing global landscape, making the U.S. economy more attractive for investment and job creation. It has been over a quarter century since Congress has reformed the tax code. During this time, global commerce has changed dramatically and many foreign countries have responded to this change by updating their international tax regimes. The United States however, continues to lag in its response to the new global landscape. For example, in 1960 nearly all of the largest global companies were American companies, with 17 of the 20 largest companies headquartered in the U.S. In 1985, only 13 of the 20 largest companies were American companies, and as of 2010, only six of the 20 largest companies in the world were American. This represents a decrease of 55% since 1960. Since 1985, Brazil, China, India, Russia and Eastern Europe moved from essentially non-market economies to fast growth developing countries whose markets have opened to global companies from the United States, Europe, Japan, China, Korea, and India. This very competitive marketplace is wide open.

To keep pace with this ever-changing global landscape, Congress should enact comprehensive tax reform legislation that:

Advancing Global Commerce for Over 90 Years

www.nftc.org

1. Lowers the U.S. corporate income tax rate in line with the rates of our trading partners to attract and retain investment in the U.S;
2. Adopts a competitive territorial tax system that imposes minimal residual home country taxation on foreign earnings without expense allocation much like those in most of the rest of the world which would allow American companies to compete on equal footing with their foreign competitors in the global marketplace;
3. Permits American companies to invest foreign earnings in the U.S. without a tax penalty, and
4. Does not disadvantage any particular industry or type of income vis-a-vis other industries or types of income.

Until such time as comprehensive tax reform can be enacted, piecemeal changes should be avoided. In particular, a robust, fully-functioning foreign tax system that prevents double taxation of U.S. companies under the existing worldwide system needs to stay in place.

The U.S. Should Reduce the Corporate Income Tax Rate

The current combined U.S. federal corporate income tax rate of 39.1% (35% federal rate plus state income tax rate) is the highest combined corporate income tax rate among the member countries of the Organisation for Economic Co-operation and Development (“OECD”). Indeed, in the world, only the Democratic Republic of the Congo and Guyana have a higher rate. The U.S.’s combined rate is nearly 15 percentage points higher than the 25% average corporate tax rate among OECD member countries.¹

The U.S. high statutory corporate income tax rate presents a number of problems for global American companies and the U.S. economy more generally. First and foremost, the high U.S. statutory rate makes the U.S. economy has a whole less attractive as a place to do business. By lowering the corporate income tax rate, the United States economy will experience a number of benefits. Recent research indicates that because the economic burden of corporate income taxes generally falls most heavily on labor,² a lower rate will effectively lead to higher wages and living standards among U.S. workers. A lower corporate tax rate will also boost investment, entrepreneurship, and productivity in the United States. Companies will have an incentive to locate their headquarters and create more offices in the United States, which will in turn create new job opportunities and improve the U.S.’s economic outlook. A reduction in the corporate income tax rate also will help attract and retain more U.S. investment, including foreign direct investment, also resulting in additional jobs and tax revenue. The statutory rate is the rate that is the measure of the net after-tax rate of return on a given investment project.

¹ See 2012 OECD Tax Database, Table II.1. 25.1% is the average combined corporate rate among OECD countries, not including the U.S.

² Tax Foundation Special Report, “Ten Benefits of Cutting the U.S. Corporate Tax Rate,” No. 192 at 3 (May 2011) (*citing* R. Alison Feliz and James R. Hines, Jr., “Corporate Taxes and Union Wages in the United States,” National Bureau of Economic Research, *Working Paper* 15263 (August 2009)).

According to a recent OECD report investigating how tax structures can best be designed to support GDP per capita growth: “The analysis suggests a tax and economic growth ranking order according to which corporate taxes are the most harmful type of tax for economic growth . . .”³ As such, the NFTC is encouraged by the fact that there appears to be a growing consensus among policymakers in both Congress and the Administration that a reduction in the corporate income tax rate is a necessary policy prescription for a higher U.S. standard of living.

Furthermore, it is very difficult for global American companies to compete with foreign companies that have the benefit of a lower corporate income rate within their respective countries. Other countries have recognized the competitive advantages of a lower corporate income tax rate and responded accordingly. Over the past four years, 75 countries have cut their corporate income tax rates in order to promote investment and create jobs.⁴ For example, Canada lowered its federal rate from 18% to 16.5% and has plans to further reduce the rate to 15%. Similarly, the United Kingdom lowered its rate from 28% to 23% and has plans to reduce the rate to 21% by 2014, and 20% by 2015. These examples demonstrate the continued lack of competitiveness of the U.S. corporate tax system, which ultimately results in slower economic growth and impedes the creation of jobs in the United States.

The high U.S. corporate income tax rate also provides a barrier to American companies seeking to expand through foreign acquisitions. Foreign-based companies that benefit from lower tax rates can typically outbid American companies for foreign targets. This makes it more difficult for worldwide American companies to enter new markets and prevents these companies from reaping the benefits of increased market share, access to key customers, cost synergies, and efficiency gains. In this regard, the United States should adopt a corporate tax system that places worldwide American companies on an equal footing with their competitors.

The U.S. Should Implement a Competitive Territorial Tax System

In addition to its high statutory corporate income tax rate, the United States also taxes American companies on their worldwide earnings whether earned in the United States or abroad. The U.S. tax system provides temporary relief to companies through deferral of tax on the active business earnings for foreign subsidiaries until those earnings are repatriated. In other words, American companies can decide either to reinvest foreign profits in their foreign operations or to bring those profits back to the United States with the consequence of having to pay residual U.S. tax on those profits. Non-American companies, on the other hand, may freely bring their non-U.S. earnings into the U.S. without a tax penalty. In contrast, a competitive territorial tax system consistent with that of most of our major trading partners would impose little or no additional home country tax on active business profits earned abroad and eliminate the current tax disincentive to repatriation. The U.S. worldwide tax system creates artificial barriers to investment within the United States. Conversely, most other countries operate under

³ OECD (2010), Tax Policy Reform and Economic Growth, OECD Publishing.
<http://dx.doi.org/10.1787/9789264091085-en>

⁴ Tax Foundation Special Report, “Ten Benefits of Cutting the U.S. Corporate Tax Rate,” No. 192 at 3 (May 2011).

territorial systems that allow foreign-based companies to deploy capital around the world without additional home country taxation.

There are numerous examples of how the current U.S. worldwide tax system puts American companies with global operations at a competitive disadvantage against foreign competitors. For example in Canada, the corporate tax rate is 15%, and that rate is sometimes reduced through tax incentives. (We do not take the various provincial rates into consideration for this example). If an American company earns \$1,000 Canada, it pays \$150 in corporate tax to Canada. If that company distributes the remaining income (\$850) to the U.S. parent, the U.S. parent must pay another \$170 to the U.S. Treasury, bringing the total tax to the 35 percent U.S. corporate rate. However, if a competitor from Germany earns \$1,000 Canada, it pays only the \$150 Canadian tax. Germany, with its territorial system, taxes only the corporate income earned inside its borders. Thus, the German company has \$170 more net income to be used to invest and grow, and that benefit will be even greater if the Canadian subsidiary benefits from local tax incentives. In each case, the Canadian subsidiary of an American company and the Canadian subsidiary of a German company can compete equally within Canada – but the overall tax burden on the American company is substantially greater.

The current U.S. worldwide tax system also impairs the ability of American companies to move capital around the world to meet business needs, particularly back into the U.S. economy with the tax penalty on repatriated foreign earnings. There are also instances where moving cash between overseas subsidiaries could lead to a U.S. tax penalty. For example, moving cash from a German subsidiary to a French subsidiary, or back to the United States, could cause a U.S. tax. While the so-called “look-through” rule and the foreign tax credit rules can mitigate that additional U.S. tax, they require American companies to implement complicated and costly monitoring and planning. Conversely, our competitors from countries with territorial systems can deploy capital around the world as needed without the added costs of taxes, or complicated and costly monitoring and planning.

Of the 34 OECD member countries, 26 use a territorial system, with only the remaining eight, including the U.S., using a worldwide system.⁵ Importantly, 18 of the 26 countries using a territorial system provide for a 100% exemption of foreign subsidiary earnings from home country taxation, and none require home country expense allocation.⁶ By switching to a competitive territorial system, the United States would encourage businesses both at home and abroad to invest in the United States. The switch would also align the United States with its global trading partners, including Canada, the United Kingdom, Germany, France, and Japan. In this regard, a move to a territorial system would place the American economy and American companies on a level playing field with competitors throughout the world. Further, a competitive territorial system would make the United States a more attractive place to locate company headquarters, new plants and service locations, which would ultimately lead to additional job opportunities in the United States.

⁵ Business Roundtable, “Taxation of American Companies in the Global Marketplace: A Primer,” at 14 (April 2011).

⁶ *Id.*

It is also important to note that, in adopting a territorial system, the U.S. should not deny deductions for interest or other expenses allocated to foreign income. Such a limitation would be inconsistent with the tax systems of every major industrialized country and would put American companies at a competitive disadvantage in both the U.S. and foreign markets. Rather than allocating expenses, many countries have implemented a 95% dividend exemption system, instead of a 100% dividend exemption system.⁷ Denying deductions for business expenses may also put the U.S. at a competitive disadvantage when global businesses are making investment and location decisions. Further, disallowing interest expense allocable to foreign income (as proposed in the U.S. Department of the Treasury FY2012 revenue proposals) would devastate U.S. banks and financial services companies for whom interest expense effectively represents the cost of raw materials. No major industrialized country has taken the approach of denying deductions for expenses allocable to deferred or exempt income, and we recommend that the U.S. system be consistent with this norm.


Neutrality Among Industries and Type of Income

Finally, comprehensive tax reform legislation should promote neutrality among industries, types of income, and taxpayers, i.e. it should avoid policies favoring one industry or type of income over another or discriminate against one taxpayer versus another engaged in the same or similar activities.

* * * * *

Thank you for the opportunity to submit these comments to the International Tax Working Group. The NFTC looks forward to working with you, your staffs, and all Members of the Committee to ensure that U.S. comprehensive tax reform facilitates and enhances the competitiveness of the U.S. economy and of globally engaged American companies.

Sincerely,

Catherine Schultz
Vice President for Tax Policy


⁷ Chairman Camp's discussion draft on international tax reform includes this 95% dividend exemption feature (one OECD country, Norway, actually uses a 97% exemption).

